Bloomberg News

Subprime, CDO Bank Losses May Exceed $265 Billion

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January 31, 2008

Losses from securities linked to subprime mortgages may exceed $265 billion as regional U.S. banks, credit unions and overseas financial institutions write down the value of their holdings, according to Standard & Poor's.

S&P cut or put on review yesterday the ratings on $534 billion of bonds and collateralized debt obligations, many of which were rated as high as AAA. The action was the broadest by the New York-based firm in response to rising delinquencies among borrowers with poor credit. Moody's Investors Service today increased its predictions for subprime-mortgage losses for at least the third time, causing it to reassess the securities.

While banks and securities firms such as Citigroup Inc. and Merrill Lynch & Co. accounted for most of the $90 billion in writedowns to date, S&P said the next wave may descend on regional U.S. banks, Asian banks and some large European banks. The ratings actions may create a ``ripple impact'' that further reduces debt prices, S&P said.

``There's a lack of confidence in the markets and this exacerbates that,'' said Anthony Davis, a banking analyst at Stifel Nicolaus & Co. in Florham Park, New Jersey. ``This will have a chilling effect on the markets.''

Widespread `Implications'

Almost half the subprime bonds rated by S&P in 2006 and early 2007 were cut or placed on review, also potentially forcing credit unions and government-sponsored enterprises such as Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks to write down their holdings, S&P said. The securities represent $270.1 billion of subprime mortgage bonds and $263.9 billion of CDOs. About 35 percent of all CDOs comprised of asset-backed securities were put under review, S&P said.

Potential forced sales by holders who must dispose of downgraded bonds may have ``implications for trading revenues, general business activity, and liquidity for the banks,'' S&P said in a statement yesterday.

Some of the largest banks have already taken ``significant'' losses related to subprime mortgages and CDOs, and aren't likely to report more writedowns, S&P said. CDOs package assets into new securities with varying risks, from AAA to unrated classes.

Moody's, also based in New York, boosted its expectations for the most likely losses on subprime loans underlying 2006 bonds to between 14 percent and 18 percent, according to a statement today. The firm plans to reassess the credit quality of the bonds in the ``next couple of weeks,'' Moody's Chief Credit Officer Nicolas Weill said in a telephone interview.

S&P Reassess

After the resolution of the downgrade reviews announced yesterday, no ``further major ration actions'' will be needed for recent subprime-mortgages securities, S&P analyst Ernestine Warner said on a conference call today. Reassessments of ``prime,'' ``Alt-A'' and earlier subprime mortgage securities will continue, she said.

S&P and Moody's are making sweeping cuts after being criticized by investors and lawmakers for their failure to better anticipate the extent of homeowner defaults. Some AAA rated CDOs lost all their value last year, and the ratings were slashed within months after the debt was created.

Accounting rules have allowed many financial companies to avoid writing down their holdings to market prices until the credit ratings fall if they intended to keep them until maturity or hold them for long periods. S&P said it will review the ratings of smaller banks that are ``thinly capitalized.'' It didn't name any of the institutions.

Regional Banks

The largest U.S. regional banks with the lowest Tier 1 capital ratios as of June 30 were Seattle-based Washington Mutual Inc.; Wachovia Corp. in Charlotte, North Carolina; National City Corp. of Cleveland; Atlanta-based SunTrust Banks Inc.; and Regions Financial Corp. in Birmingham, Alabama. Tier 1 capital measures a company's ability to cover losses.

Spokespeople for the banks either declined to comment or couldn't be reached for comment.

The nation's biggest credit unions by assets include Navy Federal Credit Union in Vienna, Virginia; State Employees Credit Union in Raleigh, North Carolina; and Pentagon Federal Credit Union in Alexandria, Virginia, according to American Banker. Spokespeople for the credit unions didn't immediately return calls for comment.

Foreclosures Increase

Analysts at Credit Suisse Group predicted earlier this month that Washington-based Fannie Mae and Mclean, Virginia- based Freddie Mac, the two largest providers of mortgage financing, could write down subprime holdings by $16 billion because they could no longer argue the declines may be reversed.

Not all of the 12 regional Federal Home Loan Banks, the cooperative lenders owned by banks and insurers, may face writedowns, Victoria Wagner, an S&P analyst, said in a telephone interview, because ``the majority of them don't hold any subprime AAA'' rated securities. As for

Fannie Mae and Freddie Mac, which have more of the bonds, the effect ``remains to be seen'' in part because the AAA bonds have only been put under review, she said.

``We expect that the U.S. housing market, especially the subprime sector, will continue to decline before it improves, and we expect housing prices will continue to come under stress,'' S&P said in the report.

House Prices Fall

S&P's move came a day after RealtyTrac Inc. said the number of U.S. homeowners entering foreclosure climbed 75 percent in 2007 from a year earlier as mortgages became more difficult to refinance and falling property values made it tougher to sell.

More than 1 percent of U.S. households were in some stage of foreclosure during the year, up from 0.58 percent in 2006, according to RealtyTrac, an Irvine, California-based seller of real estate data. Home prices in 20 U.S. metropolitan areas fell 7.7 percent in November, the 11th consecutive decline, according to the S&P/Case-Shiller home-price index released this week.

The Federal Reserve yesterday cut its target interest rate for overnight loans between banks by half a percentage point to 3 percent, the lowest since June 2005. Lower borrowing costs may help borrowers of subprime loans by reducing the scheduled rate increases on their mortgages, according to reports by analysts at banks including Wachovia and JPMorgan Chase & Co. in New York.